

EU–Mercosur and the Cost of Investment: Why Cheaper European Capital Goods Could Matter for Paraguay

The trade agreement does more than open export markets: by lowering tariffs on machinery, equipment and industrial inputs, it can change the economics of productive investment inside Paraguay.

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A trade agreement that changes the import side of investment

Most discussion of the EU–Mercosur agreement naturally concentrates on exports. For Paraguay, that usually means beef, agricultural products, processed food and the prospect of better access to a European market with far greater purchasing power than the Paraguayan domestic market. That perspective is understandable, but it captures only one side of the economics of the agreement. Productive investment also depends on what a country can import, at what cost and under what degree of certainty. A factory, logistics centre, food-processing plant, pharmaceutical operation or technology facility needs machinery, control systems, vehicles, laboratory equipment, industrial chemicals, components and specialised instruments. Much of that equipment is not produced in Paraguay. When the cost of importing it falls, the required return on the investment can fall as well.

The Interim Trade Agreement between the European Union and Mercosur has applied provisionally since 1 May 2026. The first tariff reductions therefore no longer belong to a distant scenario. They are already part of the commercial environment, even though many of the largest reductions will be phased in over several years. That gradual timetable is important because it creates a predictable path for capital expenditure. An investor can now model the likely customs treatment of a production line, a replacement cycle or an expansion programme rather than assuming that the historical Mercosur tariff will remain indefinitely.

Why capital goods matter more than ordinary imports

The distinction between consumer imports and capital goods is fundamental. A cheaper imported consumer product may raise household welfare, but cheaper productive equipment can alter the economy's capacity to produce. If a food processor can acquire more efficient packaging machinery, if a logistics operator can modernise its fleet at lower cost, or if a pharmaceutical company can import more sophisticated laboratory equipment, the tariff reduction affects not only the purchase price of the imported item but also productivity, quality, maintenance costs and the range of products that can be made locally.

This is particularly relevant to Paraguay because the country's investment proposition has long rested on a combination of moderate taxation, renewable electricity, access to Mercosur and relatively low operating costs. Those advantages are strongest when firms can combine them with modern technology. Low taxes do not compensate for obsolete equipment, and cheap electricity does not create competitiveness if production lines are inefficient. For an economy seeking to move from commodity exports towards more processing and

manufacturing, access to competitively priced capital goods is therefore part of industrial policy even when the government does not describe it in those terms.

Machinery is where the tariff numbers become economically relevant

The European Commission identifies machinery and appliances as one of the industrial sectors in which the agreement produces substantial tariff liberalisation. Before the agreement, many EU machinery and appliance exports faced Mercosur tariffs in the range of roughly 14% to 20%. Under the agreed schedule, tariffs will be dismantled for about 93% of EU exports in this category, generally over a ten-year period, with an initial reduction of approximately 1.3 to 1.7 percentage points from the first day of provisional application.

A reduction of one or two percentage points can look modest if the analysis stops at a single machine. Investment, however, is cumulative. A production project may require motors, pumps, refrigeration equipment, conveyors, packaging lines, automation, measuring devices, generators, control systems and spare parts. A project with several million dollars of imported equipment can therefore generate meaningful savings even before the tariff is fully eliminated. More importantly, the later stages of the tariff schedule can influence replacement and expansion costs for years after the original investment has been made.

The agreement also changes the competitive environment among equipment suppliers. European producers already sell substantial volumes of industrial machinery into Mercosur despite existing tariffs. As those barriers fall, they can compete more directly with Asian suppliers and with regional manufacturers. The benefit to a Paraguayan buyer may therefore exceed the statutory tariff reduction. Greater competition can affect price, credit terms, warranty conditions, after-sales service and the willingness of suppliers to maintain technicians or inventories of spare parts closer to the customer.

Transport equipment is also an industrial input

The automotive sector illustrates how quickly tariff changes can become visible. From 1 May 2026, Mercosur duties on EU electric and hybrid vehicles fell from 35% to 25%, while duties on internal-combustion vehicles were reduced from 35% to 17.5%. For car parts, tariffs are to be dismantled for 90% of EU exports over a ten-year period, with initial reductions already in force. These figures are often discussed as a consumer-market issue, but for Paraguay the productive dimension may be more important.

Transport equipment is an input into logistics, construction, agriculture, mining, services and manufacturing. Commercial vehicles, specialised trucks, warehouse equipment, agricultural machinery and replacement parts affect the cost and reliability of moving goods inside a landlocked country. Paraguay cannot change its geography, but it can reduce some of the costs associated with that geography. If the tariff component of imported transport and industrial equipment falls, part of the structural logistics disadvantage can be mitigated, even though freight, river transport and port costs remain.

Europe is already an important industrial supplier

The agreement matters because Europe is not a marginal supplier trying to enter Mercosur from zero. Eurostat data show that in 2024 the EU exported €55.2 billion of goods to the four founding Mercosur countries, with manufactured products dominating those flows.

General industrial machinery and equipment accounted for about €5.4 billion, specialised industrial machinery for another €3.4 billion, electrical machinery and appliances for around €3.0 billion, while road vehicles represented approximately €4.8 billion. The tariff agreement therefore applies to an established supply relationship rather than a hypothetical future one.

The country-level figures are also instructive. In 2024 Germany exported about €5.3 billion of machinery and electrical equipment to Mercosur, despite tariffs generally ranging from 14% to 20%. Spain exported roughly €930 million in the same category, while Italy exported around €3.1 billion. These are precisely the types of economies whose medium-sized industrial companies could become more relevant suppliers to Paraguayan projects as the tariff disadvantage is progressively reduced.

Paraguay's own trade pattern with the EU points in the same direction. In 2025, EU exports to Paraguay were worth about €900 million. Machinery and transport equipment represented 43.4% of those exports and chemicals another 30.4%. This means that the agreement is acting on categories that already dominate Paraguay's purchases from Europe. The issue is not whether Paraguayan companies will suddenly discover European technology; it is whether technology they already know becomes more competitive against alternatives from other origins.

The Paraguayan qualification: investment incentives already exempt some imports

The effect of the agreement cannot be analysed without considering Paraguay's own investment incentives. Law 7,548/2025, regulated in 2026, allows qualifying national and foreign investment projects to obtain customs-duty relief on imported capital goods and VAT exemptions on qualifying imported or locally purchased capital assets. For large projects, the regime can also provide additional benefits related to financing and dividend taxation. A company that already imports machinery free of customs duty under this regime will obviously obtain little or no additional saving from the EU–Mercosur tariff reduction on the same asset.

This qualification is important because otherwise the agreement could be oversold. A large greenfield factory structured from the beginning under Paraguay's investment-incentive regime may already have neutralised much of the tariff burden on its initial production equipment. The trade agreement therefore does not simply add a second exemption on top of an existing one. The actual benefit depends on the legal route used by the project, the tariff classification of the goods and whether the particular purchase falls within the approved investment programme.

Yet that does not make the agreement irrelevant. The largest immediate beneficiaries may include companies that do not qualify for the investment regime, smaller businesses that are modernising without a formally approved project, and existing firms buying equipment outside the original investment perimeter. The agreement can also matter after the incentive period, when machinery is replaced or new product lines are added. A factory is not built once and then frozen. Capital stock depreciates, production methods change and new equipment is required continually.

Domestic incentives and trade liberalisation can reinforce each other

Paraguay's domestic incentives and the EU–Mercosur tariff schedule should therefore be seen as complementary rather than competing instruments. The domestic regime reduces the fiscal cost of establishing a qualifying project. The trade agreement progressively lowers the ordinary commercial barrier for subsequent imports and for firms that operate outside the incentive system. Together they can reduce the difference between the cost of buying sophisticated equipment in Europe and the landed cost of placing that equipment inside a Paraguayan plant.

This interaction becomes particularly relevant for investors with long planning horizons. A company may receive exemptions on the initial production line but later need replacement machinery, laboratory instruments, warehouse systems or additional capacity not included in the original approval. The ordinary tariff schedule then matters again. Predictable liberalisation reduces the risk that a project is competitive only at the moment of establishment but becomes expensive to maintain and modernise later.

The sectoral benefits will be uneven

The benefits will not be distributed evenly across the economy. Agroindustry is an obvious candidate because Paraguay has strong agricultural output but still has room to increase domestic processing. Meat, dairy, grains, oils, animal feed and processed foods require refrigeration, quality-control systems, packaging machinery, boilers, pumps and specialised production equipment. Lower equipment costs can improve the economics of processing locally rather than exporting raw or lightly processed products.

Pharmaceuticals and medical technology are another example. These sectors depend on laboratory equipment, clean-room systems, measuring instruments, quality-control technology and specialised production machinery, much of which is imported. Paraguay has already identified pharmaceuticals, medical devices and technology-oriented manufacturing as areas with investment potential. Lower tariffs on European equipment do not create these industries by themselves, but they reduce one of the fixed costs of entering them.

Logistics, construction and warehousing may also gain because transport equipment, handling systems, refrigeration and specialised vehicles are capital-intensive. Even services can be affected where the service requires physical infrastructure: private healthcare, diagnostic laboratories, hotels, data centres and technical maintenance operations all use imported equipment. The agreement is therefore not simply an industrial-policy instrument in the narrow sense. It can lower capital costs across a wide range of productive activities.

Financing may matter as much as the tariff

For many medium-sized investors, the decisive constraint is not the nominal price of machinery but the financing package. European capital-goods manufacturers frequently compete through supplier credit, leasing arrangements, export-credit support or financing linked to banks in their home markets. As the tariff penalty falls, those financing terms become more important in the total comparison between European and non-European equipment.

This matters especially in Paraguay, where the domestic capital market remains relatively shallow and long-term financing can be more expensive or less available than in Europe. A machine that is slightly more expensive before duty can become the better investment if it offers longer financing, lower maintenance costs, higher energy efficiency or more reliable after-sales service. The tariff agreement makes it more likely that these comparisons will be decided on total economic value rather than on customs protection alone.

The new Paraguayan investment regime reinforces this point by allowing certain large projects to obtain relief on Non-Resident Income Tax for interest and related charges on qualifying foreign financing, and by allowing capital goods benefiting from the regime to form part of a fiduciary guarantee structure. The interaction between lower trade barriers and more flexible project financing can therefore be more important than either element considered separately.

Lower tariffs do not mean lower landed cost automatically

Tariff liberalisation should not be confused with the elimination of import costs. VAT treatment, customs fees, freight, insurance, inland transport, port and river logistics, financing expenses and installation costs remain relevant. A European machine that becomes duty free can still be more expensive on a landed basis than an Asian alternative if the logistics, purchase price or financing are less competitive.

Rules of origin matter as well. Preferential treatment applies to goods that satisfy the agreement's origin requirements; an item sold by a European company is not necessarily of EU origin for customs purposes. Modern machinery often contains components sourced globally. Investors therefore need to obtain the correct origin documentation from the supplier and confirm that the product qualifies under the relevant rule before incorporating the preferential tariff into the financial model.

Tariff classification is equally important. The commercial description used in a supplier's quotation is not enough. The investor must identify the correct customs code, check the applicable base rate, the agreed reduction schedule and any specific conditions. An error of classification can materially change the assumed saving. For large capital purchases, customs analysis should therefore be part of project preparation rather than an administrative task performed after the equipment has already been ordered.

Timing becomes an investment variable

Because many tariffs are being reduced gradually, timing can influence the economics of a purchase. If equipment is urgently required, postponing a productive investment merely to obtain a later tariff cut would normally make little sense. The lost production may cost more than the customs saving. But where the purchase is discretionary, or where an expansion can be scheduled within a range of dates, the tariff calendar becomes one more variable in capital budgeting.

This is particularly relevant for high-value equipment and for projects with several stages. An investor could order essential machinery immediately while timing later additions to coincide with further tariff reductions. The same logic can apply to replacement cycles. The agreement effectively creates a known declining path in part of the import cost, and

companies that plan capital expenditure over five or ten years can incorporate that path into procurement decisions.

The agreement may change sourcing strategy, not only prices

A lower tariff does more than reduce the cost of an existing purchase; it can change which supplier enters the shortlist. A Paraguayan firm that historically rejected European equipment because a 14% or 20% tariff made it uncompetitive may now reconsider the supplier as that disadvantage narrows. Once the European producer enters the procurement process, the comparison expands to energy consumption, quality, expected lifetime, financing, maintenance and output per hour.

This can have second-order effects on supplier behaviour. A European manufacturer that sees a larger addressable Mercosur market may be more willing to appoint a Paraguayan distributor, train local technicians, hold spare parts in the region or provide Spanish-language support. Those services lower the effective risk of buying imported machinery. In industrial investment, downtime and maintenance can matter more than the initial purchase price, so the development of a local or regional service network can multiply the value of tariff liberalisation.

The productivity channel deserves more attention

The most important macroeconomic effect may therefore be productivity rather than trade volume. Paraguay's competitive advantages are frequently presented in static terms: low taxes, abundant renewable energy and moderate labour costs. These are useful, but long-term growth depends on how much output firms can obtain from each worker, machine and unit of energy. Capital deepening and better technology are central to that process.

A company that can afford a more efficient production line, better quality-control equipment or more advanced automation may produce more with the same labour and energy inputs. Lower defect rates can also make it easier to enter demanding export markets. In this sense, cheaper access to European machinery can contribute indirectly to the export side of the EU–Mercosur agreement: a Paraguayan producer first imports better equipment and then uses the productivity gain to compete more effectively abroad.

The effect is particularly relevant for a small economy. Paraguay will not develop a complete domestic machinery industry across every sector, nor would that necessarily be efficient. Its competitive strategy can instead combine local production in areas of comparative advantage with open access to specialised capital goods produced elsewhere. Trade liberalisation becomes a means of importing productivity.

Small and medium-sized firms may gain disproportionately

Large multinational projects can usually obtain sophisticated customs advice and may qualify for domestic investment incentives. Smaller Paraguayan firms are less likely to have those advantages. For them, the ordinary tariff can be a direct part of the price of modernising a plant or buying a specialised machine. The progressive reduction of that tariff can therefore be particularly valuable to businesses that are too small to structure a complex incentive application but large enough to invest in imported equipment.

This matters because productivity improvements in Paraguay cannot depend only on a handful of large foreign investments. Local medium-sized manufacturers, food processors, logistics operators and service companies form the supply chains around those projects. If they can modernise more cheaply, the benefits of foreign investment are more likely to diffuse through the economy rather than remain concentrated inside isolated plants.

European suppliers may begin to look at Paraguay differently

The agreement can also alter incentives on the supplier side. A European machinery producer that previously viewed Brazil or Argentina as the only Mercosur markets large enough to justify a regional commercial presence may begin to treat Paraguay as part of a broader integrated market. Paraguay itself is small, but a local operation can support customers that produce for Brazil, Argentina or export markets while benefiting from Paraguay's lower operating costs.

The EU is already a significant investor in Paraguay, with foreign direct investment stocks of around €2 billion in 2024. The trade agreement does not guarantee that machinery suppliers will establish subsidiaries or service centres in Asunción or Alto Paraná, but it improves the economics of a regional strategy in which Paraguay is not considered in isolation. For Paraguay, attracting the supplier ecosystem around imported technology can be nearly as important as importing the machines themselves.

What investors should examine before relying on the agreement

For a company evaluating a Paraguayan project, the analysis should begin with the exact tariff classification of the machinery and inputs involved. The investor should then identify the pre-agreement tariff, the reduction schedule, the rule of origin and the documentation required to claim the preference. It should also determine whether Law 7,548/2025, another domestic incentive or a sector-specific regime already eliminates the same duty.

The next step is to calculate landed cost rather than customs duty in isolation. Freight, insurance, VAT, financing, installation, local transport, spare parts and maintenance should all be included. Competing suppliers should be compared on a life-cycle basis, not only by invoice price. Finally, the investor should consider the timetable: whether equipment is needed immediately, whether later stages can be aligned with further tariff reductions and whether an approved investment-incentive project should be structured before orders are placed.

Only after those points are clear should the tariff saving be incorporated into the financial model. A general statement that European machinery will become cheaper is too imprecise for investment decisions. For some equipment the saving will be substantial; for other assets it will be delayed, neutralised by a Paraguayan exemption or offset by logistics. The agreement creates an opportunity, not an automatic result.

The broader implication for Paraguay

For Paraguay, the EU–Mercosur agreement is often presented as a way to sell more to Europe. That remains important, but it is only half of the story. A country that wants to industrialise also needs access to the machinery, technology and intermediate goods used to produce. The capacity to import productive equipment on better terms can be as relevant to development as preferential access for final exports.

The effect will not be dramatic overnight. Tariff reductions are phased in, logistics remain important and qualifying projects may already benefit from domestic exemptions. Yet over a decade the cumulative impact can be meaningful. Lower capital costs, broader supplier competition, improved financing options and easier access to advanced equipment can strengthen the same sectors Paraguay is trying to develop through investment incentives, maquila, industrial parks and export promotion.

The strategic opportunity lies in combining these instruments. Paraguay does not need to choose between low domestic taxes and trade openness, or between investment incentives and cheaper imports. Its strongest proposition may be the combination: a relatively low-tax location with renewable energy, access to Mercosur, domestic incentives for qualifying projects and progressively cheaper access to European capital goods. If those elements are matched by infrastructure, legal certainty and skilled labour, they can improve the economics of locating production in Paraguay rather than merely selling into Paraguay from abroad.

The most important question for an investor is therefore not simply whether the EU–Mercosur agreement increases trade between Europe and South America. It is whether the new tariff structure changes the return on a specific productive project. In machinery-intensive sectors, the answer may increasingly be yes.

Sources

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